FILE COPY

No. 378

In the Supreme Court of the United States

OCTOBER TERM, 1931

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CHICAGO PORTRAIT COMPANY

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF



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v.

CHICAGO PORTRAIT COMPANY

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of David Burnet, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit entered in the above-entitled case on June 11, 1931 (R. 38), affirming the judgment of the Board of Tax Appeals (R. 22).

QUESTION PRESENTED

Whether the State of New South Wales is a "foreign country" within the meaning of Section 238

of the Revenue Act of 1921, which allows a credit against income tax on account of income taxes paid to a "foreign country."

STATEMENT

During the calendar year 1923 the respondent, an Illinois corporation, owned 51 per cent of the voting stock of, and received dividends from, the International Art Company, of Sydney, Australia. During that year the Australia corporation paid income taxes, respectively, to the Commonwealth of Australia, to the Dominion of New Zealand, and to the State of New South Wales. Petitioner included in the gross income of the respondent for 1923 the dividends received from the Australia corporation, and he allowed credits against income taxes due from respondent to the United States, on account of income taxes paid to the Commonwealth of Australia and to the Dominion of New Zealand, but refused to allow credit for any portion of the taxes paid to New South Wales. (R. 16-18.)

The respondent appealed to the Board of Tax Appeals (R. 3), which entered judgment in favor of respondent (R. 18-22). On a petition to review that judgment, the Circuit Court of Appeals for the Seventh Circuit affirmed the judgment of the Board of Tax Appeals. (R. 38.)

SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred in holding that the State of New South Wales was a "foreign

country" within the meaning of that term as used in Section 238 of the Revenue Act of 1921.

The Circuit Court of Appeals erred in holding, in effect, that Congress in enacting Section 238 intended to allow credit for income and profits taxes imposed by all governmental authority foreign to the United States.

REASONS FOR GRANTING THE WRIT

The Circuit Court of Appeals has construed the term "foreign country" as used in Section 238 of the Revenue Act of 1921 to embrace any foreign governmental authority which may impose income or profits taxes. It is believed this construction is erroneous and in conflict with the judicial definitions of the term.

The construction of the Circuit Court of Appeals is contrary to the construction given by the Treasury Department for a period of upwards of ten years. If allowed to stand, it will require credits against taxes of a kind not heretofore allowed, and necessitate refunds of taxes estimated at over $2,000,000 and will substantially affect the amount of taxes to be paid in the future by a large number of corporations.

The question presented is one of general importance, involving large sums in taxes and affecting a large number of taxpayers, which has not been but should be settled by this Court. The question arises under all of the revenue acts since the Revenue Act of 1918.

Wherefore it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Seventh Circuit should be granted.

THOMAS D. THACHER,
Solicitor General.

SEPTEMBER, 1931.

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 16–22) is reported in 16 B. T. A. 1129. The opinion of the Circuit Court of Appeals (R. 36–38) is reported in 50 F. (2d) 683.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Seventh Circuit was entered June 11, 1931. (R. 38.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the state of New South Wales is a "foreign country" within the meaning of Section 238 of the Revenue Act of 1921, which allows a credit against income tax on account of income taxes paid to a "foreign country."

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set out in the Appendix, *infra*, pp. 14–18.

STATEMENT

A statement of the facts and the errors to be relied upon will be found in the petition.

ARGUMENT

The provisions allowing a credit of taxes paid to a "foreign country" first appeared in the Revenue Act of 1918, c. 18, 40 Stat. 1057, Sections 238 (a) and 240 (c). So far as the use of these words is concerned, no change has been made by Congress in the succeeding Revenue Acts, where the same language is found in Section 238 (a) and (e) of the Acts of 1921, c. 136, 42 Stat. 227; 1924, c. 234, 43 Stat. 253 (U. S. C., Title 26, Sec. 990); and 1926, c. 27, 44 Stat. 9 (U. S. C. App., Title 26, Sec. 990), and in Section 131 (a) (1) and (f) of the Revenue Act of 1928, c. 852, 45 Stat. 791 (U. S. C. Sup. IV, Title 26, Sec. 2131).

Article 382 of Treasury Regulations 45, promulgated under the Revenue Act of 1918, defined "foreign country" as meaning "any foreign sovereign state or self-governing colony." This definition has been continued without change in all of the succeeding regulations. Article 382 of Regulations 62, under the Act of 1921; Article 382 of Regulations 65, under the Act of 1924; Article 382 of Regulations 69, under the Act of 1926; and Article 692 of Regulations 74, under the Act of 1928.

While the definition referred to has remained unchanged in all of the regulations since the Rev-

enue Act of 1918, there has been some departure therefrom in the practice of the Bureau of Internal Revenue under another section of the law. Section 222 (a) of the Revenue Act of 1921, *infra*, allows credits to alien resident individuals of income taxes paid to any foreign country, if the foreign country of which such alien resident is a citizen or subject allows a similar credit to citizens of the United States residing in such country. The regulations contain an incomplete list of countries which satisfy the credit requirement of Section 222 and those which do not do so. Article 385 of Regulations 62 (*infra*, pp. 16–18); Article 307 of Regulations 45, under the 1918 Act. Among the governmental or territorial divisions listed are some which do not meet the test of being sovereign states, in the international sense, or self-governing colonies. However, the definition embodied in Article 382 of Regulations 62 (*infra*, p. 16) has been adhered to in theory and has been consistently applied under Section 238. It is submitted that it is sound in principle.

The states of Australia, including New South Wales, and the provinces of Canada, have always been regarded as not coming within the term "foreign country" and credits have been denied under Section 238. The following rulings bearing on the term as defined in Article 382 have been made:

October 18, 1919, Solicitor's Memorandum 1187, not reported. This dealt with the status of

one of the cantons of Switzerland and, in holding that it was not a sovereign state, said:

> In the absence of some qualifying phrase, the word "country" in the revenue laws of the United States has always been held to mean the composite whole made up of all the subdivisions of a foreign State subject to the same central control. Each of the subdivisions, in this sense, is not a "country" but a part of a country.

September 28, 1921, O. D. 1050, C. B. 5, p. 194. This office decision, following S. M. 1187, *supra*, held that British Columbia did not come within the term as used in the Revenue Act of 1918.

Solicitor's Memorandum 1614, March 24, 1924, C. B. III-1, p. 227. This memorandum held that New South Wales was not a "foreign country" within the meaning of the 1918 Act and as defined in Article 382 of Regulations 45, but that it was one of the subdivisions of the Commonwealth of Australia.

It is also consistent with judicial interpretations of the words "country," "foreign country," and similar phrases, as used in various Acts relating to tariffs, to revenue, navigation, and so forth. One of the leading cases is *Stairs* v. *Peaslee*, 18 How. 521, which arose under the Tariff Act of 1851. That Act provided that the appraisal of goods imported should be on the market value of similar articles in the "principal markets of the country of produc-

tion or manufacture." The article imported was produced in Calcutta, India, shipped to the United States via Halifax, and valued on the markets of London and Liverpool. It was held that the determination of the appraisers that those cities were the principal markets of "the country of production" was authorized under the law, this Court saying (p. 526):

> * * * the word country in the revenue laws of the United States has always been construed to embrace all the possessions of a foreign State, however widely separated, which are subject to the same supreme executive and legislative control.

It is of course conceded that New South Wales is "foreign." The sole question is whether it is a "country." The definition embodied in Article 382 of Regulations 62 (*infra*, p. 16) is in accord with the meaning of the word "country" as recognized and used in international law. *United States* v. *The Ship Recorder*, 1 Blatchford 218; Wharton, Conflict of Laws, 3d Ed., Vol. 1, p. 32, Note 2; Hyde, International Law, Vol. 1, pp. 16–17; Moore, International Law Digest, Vol. 1, pp. 14–15.

We do not conceive that the language quoted above from *Stairs* v. *Peaslee* is inconsistent with the modern conception of such entities as Australia, New Zealand, and Canada as "countries." The inclusion of these dominions as "countries" in the Treasury Regulations is simply a recognition of the gradual development in interna-

tional law and politics which has given rise to the British Commonwealth of Nations. The British dominions now are "countries," although it is very possible that at the time of *Staire* v. *Peaslee* they would not have been so regarded.

The above language from *Staire* v. *Peaslee* was quoted by this Court in *Faber* v. *United States*, 221 U. S. 649, 659, which arose under the Tariff Act of 1897, where it was held that the Philippine Islands were a part of this nation, and were not "another country."

It is contended that New South Wales is not a foreign sovereign state or self-governing colony within the meaning of the statute and the regulations. It is one of the constituent states of the Commonwealth of Australia, and so far as the question here presented is concerned it bears the same relation to the Commonwealth as one of the states of the United States bears to the Federal Government. New South Wales is sovereign only in the same limited sense as is a State of the United States. It is not a sovereign in relation to foreign governments. It is not a "country."

The Commonwealth of Australia is an autonomous state under a constitution adopted in 1900. (63 Victoria, c. 12.) It is a government of granted powers. Such powers as are not exclusively vested in the Commonwealth or withdrawn from the constituent states remain with the states. (Sec. 107.) The parliament of the Commonwealth

is granted general powers, among others, over trade and commerce with other countries; telegraphic, telephonic, and like services; the naval and military defense of the Commonwealth and of the several states; navigation; quarantine; currency, coinage, and legal tender; copyrights, patents, and trade-marks; naturalization and aliens; immigration and emigration; external affairs. (Sec. 51.) From this it is apparent that whatever may have been the international status of the Colony of New South Wales prior to the adoption of the Constitution of the Commonwealth of Australia, since that time the entity empowered to deal with foreign nations and the one recognized in international law has been the Commonwealth, and New South Wales has not been a foreign country in the sense in which the term is used in international law. The Commonwealth of Australia has been recognized by the United States at various times as a foreign state or nation,[1] but no conventions or

[1] On June 19, 1905, a parcels-post convention was entered into between the two countries. (34 Stat. 2872, Pt. 3.) On March 30, 1910, the President of the United States issued a proclamation (36 Stat. 2679, Pt. 2) admitting articles imported from the Commonwealth of Australia under the terms of the minimum tariff as provided in Section 2 of the Tariff Act of 1909 (c. 6, 36 Stat. 11, 82). On April 3, 1918, the President issued a proclamation (40 Stat. 1764, Pt. 2) relative to reciprocity in connection with copyrights. This proclamation was pursuant to Section 8 of the Act of March 4, 1909 (c. 320, 35 Stat. 1075, 1077), which authorized the extension of the principle of reciprocity to citizens or subjects of a "foreign state or nation."

proclamations have been made recognizing New South Wales as a "foreign country" or a "foreign state or nation."

It is not reasonably probable that Congress intended to allow credits to corporations for taxes paid to states or other subdivisions of a foreign country, while withholding similar credits for taxes paid to the states of the United States or subdivisions thereof. Such taxes are deducted from gross income in computing net income, under Section 234 (a) (3) of the Revenue Act of 1921. This is a general provision permitting the deduction of taxes, with certain exceptions, one of which is "(b) so much of the income, war-profits and excess-profits taxes imposed by the authority of any foreign country or possession of the United States as is allowed as a credit under section 238." The taxes here would be deductible from gross income under Section 234 (a) (3) if not credited under Section 238.

The grant of the right to credit taxes paid to a foreign country is in the nature of a grant of an exemption, since the credit operates to reduce the amount of tax which would otherwise be payable. It is in the nature of an extraordinary benefit granted to the taxpayer. Such grants are construed most strongly in favor of the Government. *Cornell* v. *Coyne*, 192 U. S. 418, 431; *Bank of Commerce* v. *Tennessee*, 161 U. S. 134, 146; *Swan & Finch Co.* v. *United States*, 190 U. S. 143, 146.

CONCLUSION

It is respectfully submitted that the petition for certiorari in this case should be granted.

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SEPTEMBER, 1931.

APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227, 249, 258, 259:

SEC. 238. (a) That in the case of a domestic corporation the tax imposed by this title, plus the war-profits and excess-profits taxes, if any, shall be credited with the amount of any income, war-profits, and excess-profits taxes paid during the same taxable year to any foreign country, or to any possession of the United States: *Provided,* That the amount of credit taken under this subdivision shall in no case exceed the same proportion of the taxes, against which such credit is taken, which the taxpayer's net income (computed without deduction for any income, war-profits, and excess-profits taxes imposed by any foreign country or possession of the United States) from sources without the United States bears to its entire net income (computed without such deduction) for the same taxable year. In the case of domestic insurance companies subject to the tax imposed by section 243 or 246, the term "net income," as used in this subdivision means net income as defined in sections 245 and 246, respectively.

* * * * *

(e) For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 234), in any taxable year shall be deemed to have paid the same

proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits: *Provided,* That the credit allowed to any domestic corporation under this subdivision shall in no case exceed the same proportion of the taxes against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. The term "accumulated profits" when used in this subdivision in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income; and the Commissioner with the approval of the Secretary shall have full power to determine from the accumulated profits of what year or years such dividends were paid; treating dividends paid in the first sixty days of any year as having been paid from the accumulated profits of the preceding year or years (unless to his satisfaction shown otherwise), and in other respects treating dividends as having been paid from the most recently accumulated gains, profits, or earnings. In the case of a foreign corporation, the income, war-profits, and excess-profits taxes of which are determined on the basis of an accounting period of less than one year, the word "year" as used in this sub-

division shall be construed to mean such accounting period.

SEC. 222. (a) That the tax computed under Part II of this title shall be credited with:

(1) In the case of a citizen of the United States, the amount of any income, war-profits, and excess-profits taxes paid during the taxable year to any foreign country or to any possession of the United States; and

* * * * * *

(3) In the case of an alien resident of the United States, the amount of any such taxes paid during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; * * *

Treasury Department Regulations 62:

ART. 382. *Meaning of terms.*—"Amount of * * * taxes paid during the taxable year" means taxes proper (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the individual claiming credit. "Foreign country" includes within its meaning any foreign sovereign state or self-governing colony (for example, the Dominion of Canada), but does not include a foreign municipality (for example, Montreal) unless itself a sovereign state (for example, Hamburg). "Any possession of the United States" includes, among others, Porto Rico, the Philippines, and the Virgin Islands. As to the meaning of "sources" see section 217. See also section 2 of the statute.

ART. 385. *Countries which do or do not satisfy the similar credit requirement.*—(a)

The following is an incomplete list of the countries which satisfy the similar credit requirement of section 222 (a) (3) of the Revenue Act of 1921, either by allowing to citizens of the United States residing in such countries a credit for the amount of income, war-profits, or excess-profits taxes paid to the United States, or in imposing such taxes, by exempting from taxation the incomes received from sources within the United States by citizens of the United States residing in such countries: Bulgaria, Canada, Italy, Newfoundland, Salvador. (*b*) The following is an incomplete list of the countries which do not satisfy the similar credit requirement of section 222 (a) (3) of the Revenue Act of 1921, either by allowing no credit to citizens of the United States residing in such countries, for the amount of income, war-profits, or excess-profits taxes paid to the United States, or because such countries do not impose any income, war-profits, or excess-profits taxes: Argentina, Bahama, Belgium, Bermuda, Bolivia, Bosnia, Brazil, Chile, China, Costa Rica, Dutch Guiana, Ecuador, Egypt, Finland, France, Great Britain and Ireland, Guatemala, Herzegovina, India, Jamaica, Japan, Montenegro, Morocco, New Zealand, Nicaragua, Panama, Paraguay, Persia, Peru, Portugal, Rumania, Santo Domingo, Serbia, Siam, Straits Settlements, Sweden, Switzerland, Venezuela. The former names of certain of these territories are here used for convenience in spite of the actual or possible change in the name or sovereignty. A resident of the United States who is a citizen or subject of any country in the first list is entitled, for the purpose of the total tax due the United States for 1921 (as to fiscal years beginning in 1920, see art.

386) and subsequent years, to a credit for the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country. If he is a citizen or subject of any country in the second list, he is not entitled to such credit. If he is a citizen or subject of a country which is in neither list, then to secure the desired credit he must prove to the satisfaction of the Commissioner that his country satisfies the similar credit requirement of the statute.

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